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THE U.S. TRADE DEFICIT WITH JAPAN: "SOMETHING MUST BE DONE"

Summary

On April 30 the Office of the U.S. Trade Representative will release a new inventory of foreign trade barriers that hamstring exports of competitive American products and services. A month later USTR Carla Hills must identify priority countries for market access negotiations based on the number and the pervasiveness of their unfair import practices and the potential for expanded U.S. sales. White House watchers assume Japan will be on this Super 301 hit list, even though it is readily acknowledged that barriers explain only a small part of the yawning U.S. trade deficit with Japan. Their reasoning is simple: skipping over Japan, which accounted for 40 percent of this country's overall trade imbalance in 1988, almost certainly would trigger a backlash on Capitol Hill and in many corporate boardrooms.

While most of the Washington trade community now is preoccupied with guessing what products and practices will be targeted for market access negotiations with Tokyo, a small but influential group of businessmen, former government officials and legislators already has written off the success of the Super 301 process. This strategy, although effective in dismantling formal barriers to U.S. exports, will not eliminate the informal barriers that now are the major cause of restricted market opportunities in Japan for American suppliers, it is argued. In this view the only way to overcome such trade-distorting practices as the country's buy-national psychology and distribution system is to set import goals for Japan. This market-opening approach is anathema to the Bush administration, but it could gain support if the recent rapid expansion of U.S. exports stalls.

Tackling Market Access Problems

The U.S. trade deficit with Japan is stuck at a politically unsustainable $50 billion-plus. The gap between exports and imports did narrow from $59.8 billion (imports c.i.f.) in 1987 to $55.4 billion last year after eight years of nonstop growth (see Table 1), but the improvement was disappointingly modest given all the factors working in favor of a smaller shortfall. By itself the roughly 50 percent drop in the value of the dollar against the yen since September 1985 should have shrunk the deficit by more than $4.4 billion, many analysts argued. Add in robust domestic demand in Japan coupled with moderate economic expansion in the United States, the cumulative effects of seven Japanese market access packages dating back to December 1981 and the enhanced competitiveness of American manufacturers and the stage seemingly was set for a major correction in the bilateral trade account.

Table 1: U.S. Trade with Japan, 1979-88

(in millions of dollars; exports f.a.s., imports c.i.f.)

	Exports	Change Over Year-Earlier Period	Imports	Change Over Year-Earlier Period	Trade Balance
1979	$17,581	36.4%	$28,169	6.5%	$-10,588
1980	20,790	18.3	32,973	17.1	-12,183
1981	21,823	5.0	39,904	21.0	-18,081
1982	20,966	-3.9	39,932	0.1	-18,966
1983	21,894	4.4	43,559	9.1	-21,665
1984	23,575	7.7	60,371	38.6	-36,796
1985	22,631	-4.0	72,380	19.9	-49,749
1986	26,882	18.8	85,457	18.1	-58,575
1987	28,249	5.1	88,074	3.1	-59,825
1988	37,732	33.6	93,168	5.8	-55,436

Source: Department of Commerce

To make matters worse, the drop in the deficit increasingly looks like a one-shot improvement. U.S. sales to Japan are expected to turn in another strong performance this year, with trade policymakers both here and in Tokyo counting on continued buoyant Japanese domestic demand to spur a repeat of the big gain posted in 1988 by U.S. manufactured products (up 35.3 percent to $19.8 billion) and to keep exports of industrial and agricultural inputs on the upswing (see Table 2). At the same time, however, analysts are predicting another uptick in the growth rate of made-in-Japan products (see Table 3) despite a projected slowdown in the American economy. With purchases already so huge, simple arithmetic indicates that anything more than last year's import increase will cancel out the deficit-reducing effects of higher exports.

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Table 2: U.S. Exports to Japan, 1987-88

(in millions of dollars, f.a.s. value)

	1987	1988	Percent Change
Total Exports	$28,248.6	$37,732.1	33.6%
Industrial Supplies	10,247.0	12,951.4	26.4
Bituminous Coal	484.5	597.5	23.3
Petroleum Products	661.3	657.9	-0.5
Logs and Lumber	1,573.4	1,906.2	21.2
Paper Base Stocks	756.7	1,051.5	39.0
Paper and Paper Products	404.1	476.6	17.9
Organic Chemicals	870.4	1,105.6	27.0
Inorganic Chemicals	831.5	887.7	6.8
Plastics and Synthetic Resin Compounds	422.8	544.4	28.8
Nonferrous Ores and Scrap	553.9	892.7	61.2
Nonferrous Metals	394.3	826.3	109.6
Raw Cotton	413.7	484.0	17.0
Hides and Skins	369.6	465.0	25.8
Capital Goods	7,290.4	10,059.9	38.0
Electric Machinery	471.2	629.3	33.5
Nonelectric Machinery	4,873.2	7,103.0	45.8
Industrial and Service Machinery	1,602.4	2,453.1	53.1
Computers, Peripherals and Semiconductors	2,038.8	2,976.9	46.0
Telecommunications Equipment	418.9	585.8	39.8
Scientific and Medical Equipment	557.2	747.6	34.2
Transportation Equipment	1,945.9	2,327.7	19.6
Civilian Aircraft	1,094.9	1,288.8	17.7
Civilian Aircraft Parts	796.0	854.6	7.4
Food, Feed and Beverages	5,578.9	7,964.2	42.8
Corn	1,036.0	1,616.2	56.0
Soybeans	785.7	1,030.1	31.1
Wheat	352.3	425.5	20.8
Fruits and Vegetables	664.5	822.1	-23.7
Meat and Meat Products	898.3	1,375.4	53.1
Fish and Fish Products	1,058.8	1,576.4	48.9
Consumer Goods	2,548.0	3,273.0	28.5
Nondurables	1,612.5	1,944.4	20.6
Pharmaceuticals	679.7	784.8	15.5
Cigarettes	491.9	606.3	23.3
Durables	783.1	1,112.5	42.1
Recreational Equipment	256.7	390.5	52.1
Gems, Jewelry and Collectibles	244.0	326.6	33.8
Automotive Products	361.8	776.7	114.7
Automotive Parts, Engines, Bodies and Chassis	253.4	417.4	64.7
Other Exports	1,345.0	1,690.5	25.7

Source: Department of Commerce

Table 3: U.S. Imports from Japan, 1987-88

(in millions of dollars, Customs value)

	1987	1988	Percent Change
Total Imports	$84,575.0	$89,802.1	6.2%
Capital Goods	27,576.6	32,823.8	19.0
Electric Machinery	2,937.4	3,566.0	21.4
Nonelectric Machinery	24,120.7	28,701.9	19.0
Construction, Mining and Drilling Equipment	1,079.2	1,376.1	27.5
Industrial and Service Machinery	7,230.3	8,465.3	17.1
Agricultural Machinery	550.4	494.0	-10.2
Computers, Peripherals and Semiconductors	8,341.6	11,058.0	32.6
Other Business Machines	2,414.0	2,458.4	1.8
Telecommunications Equipment	3,640.5	3,867.7	6.2
Scientific and Medical Equipment	864.8	982.3	13.6
Transportation Equipment	518.5	555.9	7.2
Civilian Aircraft, Engines and Parts	303.6	405.4	33.5
Automotive Products	33,733.5	32,765.1	-2.9
Cars	21,306.6	19,879.9	-6.7
Trucks and Special-Purpose Vehicles	4,961.2	3,733.7	-24.7
Automotive Parts, Engines, Bodies and Chassis	7,465.8	9,151.6	22.6
Consumer Goods	13,946.7	14,252.2	2.2
Nondurables	1,396.6	1,452.7	4.0
Apparel, Footwear and Household Goods	455.8	364.9	-19.9
Durables	12,410.7	12,638.7	1.8
Household Goods	1,938.8	1,788.7	-7.7
Recreational Equipment	3,434.6	4,201.3	22.3
Home Entertainment Equipment	6,448.5	6,046.2	-6.2
Gems, Jewelry and Collectibles	588.8	602.6	2.3
Intermediate Goods	8,046.4	8,585.0	6.7
Steel Mill Products	2,214.7	2,666.1	20.4
Organic Chemicals	846.9	887.2	4.8
Textiles	755.5	675.0	-10.7
Food, Feed and Beverages	458.8	396.0	-13.7
Other Imports	813.0	980.0	20.5

Source: Department of Commerce

Current strategies for rectifying the U.S.-Japan trade imbalance clearly are not working. That does not surprise economists who have been arguing for years that realignment of the dollar-yen exchange rate and faster, domestic-led growth in Japan are necessary but not sufficient conditions for progress on the bilateral trade front. Their standard prescription at the macroeconomic level

includes slashing the federal budget deficit and boosting this country's personal savings rate as well as some supplemental decline in the dollar's value and continued strong economic expansion in Japan through further restructuring. Additional advances in U.S. industrial productivity, product quality and cost control and a more open Japanese market are key elements of the microeconomic counterpart.

While paying lip service to the need for macroeconomic changes in the United States, many American legislators and business executives are looking for a faster, less painful solution to the huge U.S. trade gap with Japan. The broad support for limits on sales here of Japanese-made cars, machine tools, steel and textiles comes under this heading, but adding products to the list is a nonstarter, at least for now, since the Bush White House is on record as opposing protectionism. That leaves opening Japanese markets -- the stated trade policy of the current administration -- as the only quick-fix candidate. Capitol Hill and the business community long have endorsed this strategy for dealing with the bilateral trade deficit, but recent support has been lukewarm at best because of the checkered results from Reagan administration efforts to negotiate expanded market opportunities in Japan for American suppliers.

Washington has tried a variety of market access negotiating tactics over the years: tackling specific product problems on a case-by-case basis, going after the full range of import barriers in certain industries (the MOSS or market-oriented, sector-selective talks), and self-initiating formal investigations under Section 301 of the 1974 Trade Act of unfair Japanese trade policies and practices at home. Whatever the tactics, many lawmakers and businessmen have come to the conclusion that negotiating the elimination of import barriers in Japan is a never-ending process; the removal of one obstacle to U.S. sales just reveals another. Critics also charge that the White House allows market access negotiations with Tokyo to drag on and then often settles for a Japanese response short of the administration's initial goals. An extension of this complaint is that U.S. trade policymakers are reluctant to retaliate against Japan for inadequate compliance with a market-opening agreement. Capitol Hill and corporate proponents of a more aggressive policy toward Japan fault the executive branch as well for its failure to target some clear-cut barriers to U.S. exports.

Congressional and business-sector frustration with the administration's handling of trade relations with Japan found a partial outlet in the sections of the 1988 Omnibus Trade and Competitiveness Act on foreign unfair trade policies and practices. The legislation amended Section 301 in several places. In broadbrush terms it mandated action by the White House if a trade agreement is violated or if a foreign practice is "unjustified" -- inconsistent with other international legal rights of the United States. It also spelled out specific "unreasonable" practices that are actionable, including inadequate or ineffective protection of intellectual property rights, foreign government toleration of "systematic anticompetitive activities" by local companies, and export targeting. Other changes included transferring from the president to the U.S. Trade Representative the authority to take steps to win the elimination of unfair foreign trade practices, revising the timetable for Section 301 investigations and setting a deadline for retaliatory action.

The main legislative release valve for critics of recent administration efforts to open markets in Japan was the part of the new trade law universally

dubbed Super 301. On paper the Super 301 process is relatively straightforward. On April 30 the Office of the U.S. Trade Representative will send to Congress its fourth annual inventory of significant foreign barriers to U.S. exports of goods and services as well as to direct investment by American companies and to intellectual property rights. This time the survey also will include estimates of the value of U.S. trade or foreign investment affected in 1988. Using this report as a starting point, USTR Carla Hills must come up with a set of U.S. trade liberalization priorities by May 30.

The trade act lists three guidelines for selecting priority foreign barriers and trade-distorting practices, starting with the international competitive position and the export potential of American suppliers. It also provides general criteria for targeting priority countries -- namely, the number and the pervasiveness of a trading partner's barriers and the projected value of U.S. exports if that country were fully implementing existing trade agreements. Also factoring indirectly into this part of the selection process is the estimated value of sales lost last year because of trade policies or practices identified as priority barriers.

By June 20 the Bush administration must launch investigations of each of the trade barriers tagged priority. The primary goal of these proceedings, conducted under the same rules as regular 301 inquiries, is to negotiate an agreement to eliminate the priority practice within three years, with the expectation that U.S. exports will expand incrementally each year during this period. The fallback objective is to win compensation if a foreign government decides to keep a priority barrier in place. If the negotiations fail altogether, the White House has the option within certain limits to take retaliatory action for four years.

Although a watered-down version of the original proposal for reducing the U.S. trade deficit with countries like Japan, the Super 301 provision has become a source of controversy in Washington and worry in Tokyo and other foreign capitals as the implementation date nears. Part of the debate comes from second-guessing exactly what type of foreign trade practices lawmakers intended for Super 301 coverage. A number of trade lawyers maintain that the legislative history of Super 301 clearly indicates that this provision was designed to combat generic or systemic foreign trade practices, not run-of-the-mill barriers to U.S. exports such as high tariffs and quotas. Legislators involved in drafting Super 301 have backed this interpretation in recent weeks, noting that they were particularly concerned about informal unfair trade practices like the buy-national attitude prevalent in Japan and its distribution system.

The Japan example highlights a second source of controversy: which countries did Congress think were prime candidates for priority status? Sen. John Danforth (R, Mo.), ranking minority member of the Finance Committee's international trade subcommittee, told USTR Hills earlier this year that legislators clearly had Japan in mind when they wrote the Super 301 section. Other lawmakers subsequently have voiced this opinion. There also is another indication of congressional intent. U.S. trade problems with Japan rated a "sense of the Congress" section in the 1988 trade bill, which focused on the need for high-level negotiations to improve market opportunities for American goods, particularly manufactured products.

The Bush White House is in a bind. If it does not name Japan a Super 301 priority country, it risks a backlash on Capitol Hill, but if this country's

number-two export customer is branded a pervasive unfair trader, the outcome could be the same in Tokyo. Even administration proponents of designating Japan a priority country recognize that this tag could sour the negotiating environment. They also are aware of the problems of reaching government-to-government agreements on an end to the private-sector institutional or structural factors that analysts and exporters alike consider to be the main obstacles to expanded U.S. sales of manufactured products. These reservations notwithstanding, the current betting in Washington is that Japan will get caught in the Super 301 net. The only question is which products or practices will be targeted.

First Elimination Round

The inventory of significant foreign barriers to U.S. exports, which is scheduled for release April 30, no doubt will be based primarily on USTR's 1987 National Trade Estimate Report. That document listed Japanese barriers to 18 specific products or product groups spanning high tariffs, quotas, standards, government procurement and private-sector actions, as well as six generic problems, including the distribution system. Impediments to the provision of five types of services also were identified, plus export credits and inadequate protection of intellectual property.

This catalog of 31 barriers is a somewhat misleading indicator of market accessibility in Japan for foreign, especially American, competitors. The discussion accompanying the listing indicates that as of late 1987 Washington was satisfied with Tokyo's efforts to remove roughly one-third of the cited obstacles to U.S. exports and about half of the product-specific barriers. This assessment is unlikely to have changed in the intervening months. Moreover, the trade figures for 1988, including Japanese import statistics as well as U.S. export numbers, and market share data support the view that Japan has made or is making more than sufficient progress in dismantling the barriers that have impeded exports of a substantial group of American-supplied products. While room undoubtedly exists for additional sales in some areas, these products presumably are not candidates for Super 301 priority designation.

Cigarettes - Opening the world's second-largest cigarette market to unrestricted U.S. competition was one of the Reagan administration's market access success stories, although this outcome took years of pressure and finally a threat of retaliation to achieve. On April 1, 1987 Japan suspended its tariff on cigarettes, which had been cut in two stages earlier in the decade from 90 percent to 20 percent. This move actually had double benefits for the three big American cigarette manufacturers since it also eliminated the "tax on a tax" problem (the fact that Japan's tobacco excise tax was calculated on the after-tariff price of imported cigarettes) that U.S. companies considered their major marketing handicap. Previously Tokyo had removed all restrictions on access to retail outlets, allowed foreign suppliers to set up their own distribution networks, eased advertising regulations and modified the price-approval system.

The impact of these changes on U.S. cigarette exports to Japan has been dramatic. From $95 million in 1985, sales skyrocketed to $606 million last year. At the same time Philip Morris Inc., R.J. Reynolds Tobacco Co. and Brown and Williamson Tobacco Corp., which together control well over 90 percent of Japan's imported cigarette sales, made significant market inroads. The foreign share of the market, limited to a mere 2.4 percent in FY 1985, jumped to 8.8 percent in the April 1987-March 1988 period and on to 12.1 percent in FY 1988.

These gains were all the more impressive because the American trio was fighting for share in a shrinking market.

Leather and Leather Footwear - Improving access to Japan's leather and leather footwear markets also was a protracted process, one that finally ended in a standoff. In April 1986 Tokyo replaced the straight quotas on leather and leather footwear with tariff quotas. Imports above the TQ volumes are subject to a 60 percent tariff; within the limits foreign leather is dutiable at 15 or 20 percent and leather footwear at 27 or 30 percent. At the time this issue was settled American trade officials said the new system was no less restrictive than the old one. This assessment has been proved off-base. U.S. exports of all types of leather expanded from $21 million in 1985 to $50 million in 1988. Part of this gain reflected higher prices, but volume was up. For example, shipments of upholstery leather, the main export product, doubled between 1987 and last year. Similarly, exports of leather footwear totaled $20 million in 1988 compared with $3 million-plus three years earlier, which made Japan the number-two U.S. export market. In fact, though, European suppliers have been the main beneficiaries of the changes in the Japanese leather and leather footwear import system. That really is no surprise since the United States buys more leather from abroad than it sells and is a big net importer of leather footwear, mainly from Europe.

Aluminum - As part of the complex 1985 settlement of the leather/leather footwear case, Tokyo agreed to cut its tariffs on primary aluminum (9 percent) and semifabricated aluminum products (various rates) to the U.S. levels of 1 percent and 3 percent, respectively, by January 1988. This move, partly implemented ahead of schedule, addressed one of the American aluminum industry's complaints about limited sales in the world's second-largest aluminum market, but the trade effects of the tariff reductions are hard to isolate.

Japanese aluminum fabricators, which now are supplied by just one small domestic smelter, are the top international buyers of primary aluminum, importing 2.5 million tons in 1988 -- 46 percent more than in 1985. Most ingot is bought under long-term contract or from joint ventures abroad. Ingot purchased from the United States, however, generally is acquired on the spot market. This puts U.S. suppliers at a disadvantage in periods of tight supply like 1988. Nevertheless, American companies shipped $673 million worth of primary aluminum to Japan last year, equal to about 14 percent of total Japanese imports on a volume basis, plus another $442 million in scrap.

U.S. aluminum manufacturers also exported $46 million in plate, sheet and strip to Japan in 1988 -- four-and-a-half times 1985's total. That increase was an encouraging development for an industry that long has complained that it was dogged at home by stiff Japanese competition in the important canstock market but had trouble selling similar products in Japan. The tables are turning quickly, however, in part due to the dollar-yen realignment but also because of improved U.S. product quality. Instead of U.S. imports of Japanese flat-rolled aluminum products outweighing exports by a 91-to-1 margin as in 1985, the gap has shrunk to 3 to 1.

Grapefruit and Other Foods - While bulk agricultural commodities generally enter Japan duty-free, tariffs on other farm products and processed foods of interest to U.S. suppliers can be high. Washington's long-running call for reductions in these levies finally was answered last summer. As compensation

for the delay in freeing imports of beef, oranges and orange juice (see below), Tokyo agreed to lower or eliminate the tariffs on 12 food products effective April 1 of this year. On the same date the duties on 13 other foods were cut in exchange for the continuation of import restrictions on certain dairy products and starches that the General Agreement on Tariffs and Trade said violated international trade rules (see below).

Winning Japanese agreement to trim the tariff on grapefruit from 25 percent during the in-season for Japanese oranges and 12 percent in the off-season to 10 percent year-round was a major trade-off. While helpful, this change, which will be implemented next April following an intermediate cut this month, is unlikely to lift U.S. grapefruit exports much above 1988's level of $122 million. Japanese consumption of citrus fruit, especially fresh citrus, already is relatively high; moreover, the increasing availability of a wide range of comparably priced fruits will limit future grapefruit demand. Similarly, the reduction in the duty on walnuts, another U.S. tariff priority, probably will not generate much additional trade since the duties on competing nuts are all below the 10 percent rate now charged on walnuts.

Beef and Oranges - Perseverance usually pays off in negotiating more open markets in Japan. That is the moral of the prolonged U.S. attempt to win the elimination of Japan's import quotas on beef, oranges and orange juice. Last June Tokyo finally consented to liberalize imports of beef and oranges in April 1991 and orange juice a year later. In the interim quota quantities will be boosted annually (see JEI Report No. 42A, November 4, 1988). The first hike in the beef quota (for FY 1988) already has had a major impact on U.S. beef shipments to Japan, long the dominant foreign customer for this product. Exports of fresh, chilled and frozen beef jumped from 91,000 tons valued at $351 million in 1985 to nearly 178,000 tons worth $829 million last year; sales of beef offals, some of which comes under the quota, added another $177 million to the total. In the process the United States upped its share of both Japanese imports (41.7 percent in 1988 versus 30.8 percent three years before) and apparent Japanese supply (13.2 percent compared with 1985's 6.6 percent figure). These gains are certain to continue as Japan moves closer to unrestricted trade in beef.

The benefits to U.S. producers of the move toward free trade in oranges have been slower to materialize, but that was expected. Japan's imports of oranges from the United States, virtually the exclusive supplier, were barely higher in 1988 than in 1985. There also are reports that the FY 1988 quota could not be filled because of sluggish Japanese demand, held down by the same factors that limit grapefruit consumption.

"GATT 11" Products - U.S. persistence also was rewarded last summer when the Japanese government agreed to phase out by April 1990 the GATT-inconsistent quotas on seven categories of processed foods -- processed cheese, fruit purees and pastes, canned pineapple and fruit pulp, tomato juice and noncitrus fruit juices, ketchup and tomato sauces, sugars and sugar syrups, and a miscellaneous group of sugar-based food products. The agreement also covered partial liberalization by the same date of two other GATT-incompatible quota categories -- various milk and cream products and starches (see JEI Report No. 29B, July 29, 1988). Simultaneously, Tokyo promised to raise the import ceiling over three years for peanuts and dried peas and beans, the two quota groups GATT said Japan could maintain if import volumes were expanded. Overall, these changes

are expected to double U.S. exports, which totaled about $80 million in 1987, by the start of the 1990s.

Fish - With the pending elimination of most of Japan's quotas on foreign agricultural commodities, the six quotas on fish imports will be among the nation's few remaining quantitative restraints. As it is, the trade-distorting effects of these limits are hard to discern, either overall or on market opportunities for American fishermen. U.S. fish sales to Japan, which takes roughly two-thirds of total exports, more than doubled between 1985 and 1988 to nearly $1.6 billion. Most of this growth represented higher prices across-the-board, but volume did expand, both in the aggregate and in the quota categories of particular interest to the United States -- herring, pollack and cod. Concurrently, Japan's fish imports from all suppliers increased by well over 100 percent in dollar terms during the 1985-88 period, supported by a 50 percent jump in quantity to 2.3 million tons. Fish caught by American vessels, primarily salmon, made up about one-fifth of this total. With both the United States and the Soviet Union tightening restrictions on Japanese fishing operations in their coastal waters, Japan's fish imports will continue to expand at a fast pace, providing a growth market for U.S. competitors.

Second Elimination Round

A second group of products listed in USTR's 1987 National Trade Estimate Report also can be scratched with some confidence as candidates for Super 301 priority designation. Like the products expected to be eliminated in the first round, these exports have some common characteristics. U.S. sales of each have increased over the last four years, but they have not reached their potential. The reason, American suppliers say, is that while major barriers to their products have been dismantled or reduced, the Japanese government has not addressed all their marketing concerns. U.S. trade officials generally agree with this assessment but seem inclined at this point to work on these problems through established bilateral channels rather than in the Super 301 context.

Alcoholic Beverages and Wine - Virtually unnoticed Japan has become the best foreign customer for American wine, beer and distilled alcoholic beverages. Part of this change reflects normal market growth and the weaker dollar, but tariff cuts have been the major factor. The duties on wine and distilled spirits have been lowered twice since 1985, beer tariffs once. The reductions were fairly significant. On table wine, for example, the import charge dropped from 38 percent or Y280 ($2.24 at Y125=$1.00) per liter, whichever was lower given a minimum duty of Y166 ($1.33), in April 1985 to 21.3 percent or Y156.8 ($1.25) per liter in April 1987 when the minimum levy went to Y93 ($0.74).

These reductions partially addressed one major U.S. concern. The recently introduced changes in Japan's excise taxes on alcoholic beverages (see JEI Report No. 45B, December 2, 1988) went a long way toward resolving the other big American complaint. As part of this overhaul, the grading system for table wine -- which penalized higher-value products, such as most imports -- was scrapped, and the excise tax was slashed from Y159.8 ($1.28) a liter in most cases to a uniform Y46.3 ($0.37). The grading system for whiskey was retained, but the tax rates generally applicable to imports were decreased. The excise tax on beer regardless of type also was cut modestly.

The tax revisions will keep U.S. exports on the upswing, although Japanese distribution licenses for alcoholic beverages reportedly are hard to obtain

and the government has been slow to grant liquor licenses to big supermarkets, which typically stock a greater volume and a larger variety of imported products. Even without the tax changes, American wine sales had jumped to nearly $21 million in 1988 from $3 million in 1985, beer exports went from about $3 million to $17 million and deliveries of distilled alcoholic beverages, primarily bourbon, had climbed from $8 million to $47 million. Exports to Japan from European companies, the main foreign competitors, underwent the same dramatic growth. That combination boosted the import share on a volume basis of Japan's wine market to more than 40 percent last year and raised the foreign slice of whiskey sales to nearly 15 percent.

Candy and Chocolate Confectionery - Japan also has developed into the top export market for American chocolate manufacturers. The drop in the dollar's value has been a boon to sales since it widened the gap between Japanese prices for sugar and dairy products, which represent roughly three-fifths of the costs of production, and the American industry's lower ingredient costs. The April 1988 halving of the chocolate tariff to 10 percent gave a one-two punch to exports, inflating them from about $9 million in 1985 to $44 million last year. The corresponding volume gain raised the U.S. share of consumption in the slow-growing Japanese chocolate market from 1 percent to an estimated 4 percent. These inroads, in turn, helped to lift the foreign market share by seven points to 11 percent in 1988. Additional gains will be harder, U.S. producers maintain, because of Japan's sales promotion restrictions and food standards (see below).

Candy is an entirely different matter. Over the last four years U.S. exports have increased by less than $3 million, limiting the 1988 figure to a mere $5 million. The reason is simple, makers say. Candy is a price-sensitive product and Japan's tariff still is 35 percent despite repeated American calls for a cut to the U.S. level of 7 percent.

Pharmaceuticals and Medical Devices - These products were one of the success stories of the MOSS discussions, the in-depth, high-level 1985 sectoral negotiations to improve Japanese market opportunities for extremely competitive American exports. After more than two years of fruitless bilateral discussion of the trade effects of Japan's regulatory system on U.S. manufacturers of drugs and medical equipment, Tokyo agreed in short order during the MOSS talks to implement 90 percent-plus of the changes proposed by the Reagan administration. In perhaps the most significant reversal, Japan, with a few exceptions, started accepting foreign clinical test data as the basis for registering new pharmaceuticals, medical devices and in vitro diagnostic reagents. The government also made the approval process for new products more transparent and faster and streamlined the product reapproval system.

These and other regulatory reforms have made it easier for American competitors to do business in Japan's big drug and medical equipment markets, U.S. industry and government officials agree. Yet neither this development nor the U.S. lead in a number of emerging Japanese growth markets are reflected fully in the export numbers. Sales of pharmaceuticals, for example, only increased from $570 million in 1985 to $785 million in 1988. One reason was an AIDS-related cutback in the formerly big trade in blood products. Perhaps more important, most big U.S. drug houses and, to a lesser extent, medical equipment companies (which posted Japan-bound sales of $420 million in 1988 -- up from 1985's total of $244 million) have manufacturing operations in Japan and/or

have licensed production of major products to Japanese partners. In addition, American firms still face some regulatory hurdles in Japan, including the Ministry of Health and Welfare's process for revising new drug prices, but these problems, it appears, are not grist for Super 301.

Telecommunications Equipment - At the end of the MOSS negotiations on telecommunications equipment, Reagan administration trade policymakers admitted in off-the-record comments that the talks had succeeded beyond all expectations. Japan readily pared its technical standards for telecommunications terminal equipment (customer-premises equipment) to those designed mainly to prevent harm to the network. A similar criterion -- noninterference with the spectrum -- was established for radio equipment. Tokyo also allowed foreign manufacturers of CPE as well as radio equipment makers to submit their own test results, making self-certification possible, and it set up impartial systems for approving both types of equipment.

Although U.S. government officials have given Japan generally high marks for following through on these and other regulatory changes, many Washington watchers think telecommunications equipment is a leading Super 301 candidate because business has fallen far short of expectations. Japanese purchases, whether overall or from American manufacturers alone, admittedly have been modest, although imports have expanded in real terms. For example, U.S. exports of telecommunications equipment narrowly defined increased from $42 million in 1985 to only $118 million last year, a figure that included $93 million in telephone equipment. Inaccurate forecasts, however, are not automatic grounds for Super 301 designation. In any case U.S. access to Japan's telecommunications equipment market is on a different statutory track (see JEI Report No. 9B, March 3, 1989).

Motorola Inc., however, is trying to harness the Super 301 process to get Japanese action on some longstanding complaints about access to the wireless communications market. The company never has been satisfied with the Ministry of Posts and Telecommunications' 1987 decision to carve up Japan's cellular mobile communications market into service districts and to allow only one competitor in addition to Nippon Telegraph and Telephone Corp. in each area. The corporation adopting the Motorola system was assigned to the western part of Japan, while the firm using a competing domestic format was given the huge Tokyo/Nagoya region. Motorola also has been critical of MPT's handling of issues related to third-party mobile radio services.

General Regulatory Problems - With many of Japan's high tariffs on processed foods coming down, the U.S. food industry is zeroing in on what it considers to be another major deterrent to greater exports -- food standards. Despite promises of faster action, the Health and Welfare Ministry has been slow to recognize and permit the use of internationally accepted ingredients and new food additives. The same situation applies to approving new uses for already-approved additives. Even when additives are accepted for use, American food processors complain, Japan's standards often are more restrictive than those here and/or in Europe.

U.S. industry support for action on food additive issues, while broad, is too thin to have any impact on the Super 301 selection process. That also is true of Japan's industrial and agricultural product quality systems -- the

JIS (Japan Industrial Standards) mark and the comparable JAS (Japan Agricultural Standards) one, which are voluntary but are effective marketing tools. In this area, moreover, progress has been made. Several U.S. organizations like Underwriters Laboratories, Inc. now are allowed to conduct factory inspections and do product testing to certify that American goods meet the requirements for JIS and JAS marks. In addition, foreign manufacturers have some input in the JIS standards-drafting process.

Government Procurement Code - Tokyo also has reformed its own purchasing procedures and practices enough to make government procurement code implementation a noncandidate. According to the government, 81 percent by value of the contracts let in 1987 by the 67 Japanese organizations subject to the GATT procurement code were awarded on the basis of competitive tendering -- a figure it says compared favorably with the European Community performance but was below the U.S. ratio. In addition, information on the tendering process is more readily available, and bidders now have at least 40 days, the GATT minimum, to submit proposals. As a result of changes like these, Tokyo adds, government purchases of foreign products increased 26 percent in 1987 to Y54.8 billion ($438 million), which represented about 13 percent of the total procurement by the entities covered by the GATT code.

Promotional Restrictions - Restrictions on promotional activities are one reason sales in Japan of American consumer durables and nondurables are limited, U.S. industry and government officials long have argued. Newcomers to the Japanese market, whether domestic or foreign, regard sales promotions using coupons, rebates, sweepstakes or premiums as essential marketing tools for encouraging first-time and repeat purchases and creating brand awareness, yet, in the name of consumer protection, the country's Premium Law limits the value of promotional offers to "trifling" amounts. Some changes were made at the start of this year, but the United States considers them to be just a first step. Administration representatives therefore are expected to continue discussions with Japan's Fair Trade Commission.

The Short List

Probably seven products plus Japan's distribution system will survive the preliminary elimination rounds. A service sector also might be on the short list of candidates for Super 301 priority designation, most likely construction and engineering. The seven products expected to make the cut will do so for different reasons. For four of the probable finalists, barriers -- often informal -- prevent U.S. suppliers from realizing their full competitive potential. American producers of the other three last-round candidates are excluded from the Japanese market or at least an important part of it. This does not make them automatic Super 301 priority products. In fact, the products targeted for investigation and possible sanctions if market-opening negotiations fail probably will be drawn from the former group.

Rice - Twice in the last 30 months American rice growers and millers have tried to capitalize on election-year pressures and force the White House to challenge Japan's near-total ban on rice imports. Both times former USTR Clayton Yeutter thwarted the industry's attempt while acknowledging the merits of the Rice Millers' Association complaint (see JEI Report No. 42B, November 4, 1988). RMA once again is trying to take advantage of a favorable political climate to press its case against Japan's rice program. Interestingly, though,

in comments recently submitted to the USTR's office the trade association did not specifically ask the government to target Tokyo's rice policies as part of the Super 301 process. Spokesmen earlier had indicated that such a move was one of three options being explored.

The rice industry might have to look more closely at the alternatives (a regular Section 301 filing or a legislative response). The Bush administration does not seem inclined to go back on Washington's previous pledge that market access for foreign rice would be discussed only in the context of the Uruguay Round of multilateral trade negotiations. Even without that promise there appears to be little support in the government for tackling Tokyo's virtual import ban at this time. Having forced Japan last summer to agree to open its beef and orange markets, Washington is not anxious for a fight over the more politically sensitive rice issue, particularly when the potential gains to U.S. rice growers and millers are not as clear-cut as their trade group claims.

Satellites - Japan's satellite development program, a hot topic five years ago when U.S. concerns about Japanese industrial targeting were at their peak, no longer ranks as a major bilateral trade issue. The Bush administration shows no signs of reviving it, in part because of some modifications in Tokyo's previous ban on purchases of both applications (communications, broadcasting, weather and earth-observation) satellites and scientific spacecraft from foreign manufacturers.

After the domestic telecommunications market was deregulated in 1985, the Japanese government licensed two joint ventures to provide satellite communications services. Both companies -- Japan Communications Satellite Co., Ltd., a partnership of C. Itoh & Co., Ltd., Mitsui & Co., Ltd. and Hughes Communications Inc., and Space Communications Corp., a Mitsubishi Group venture -- contracted for American-built spacecraft and foreign launch services. JCSAT 1, a Hughes Aircraft Co. HS-393 satellite, was launched in March; JCSAT 2, another Hughes spacecraft, is scheduled to go up this fall. SCC's two satellites, Superbirds manufactured by Ford Aerospace and Communications Corp., also are set for launch this year.

Tokyo still prohibits purchases of foreign spacecraft by government-affiliated satellite users -- a ban that apparently covers NTT until the government becomes a minority stockholder in 1991 or 1992. But some cracks have appeared in this policy. NTT, which up to now has had to share space on a domestically built communications satellite with government agencies and private customers, reportedly has leased transponders on JCSAT 1. Moreover, earlier this year Japan Broadcasting Corp. (NHK), the country's public broadcasting company, ordered an auxiliary broadcast satellite from General Electric Co. to back up its malfunctioning spare until a new NEC Corp.-made spacecraft is launched in late summer 1990.

Supercomputers - On paper supercomputers are an ideal candidate for Super 301 priority designation. Cray Research Inc. is the world industry leader, producing perhaps three-fourths of the supercomputers now in use. Yet it has had trouble gaining anything more than a toehold in the Japanese market where it faces an aggressive trio of domestic competitors. The company has had some success in selling equipment to private-sector users, particularly Japan's automotive makers. The public sector, which includes research institutions and national universities as well as government agencies, is another story. Of the

14 supercomputers that Cray has delivered to Japan or has on order, only one -- a system ordered in the spring of 1987 by the Ministry of International Trade and Industry for its Agency for Industrial Science and Technology -- has gone in recent years to a publicly funded organization, although the government sector accounts for almost half of all supercomputer installations in Japan.

Repeated U.S. complaints that buy-national procurement policies denied Cray and Control Data Corp. (which recently announced that it was getting out of the supercomputer business) a fair chance to compete for publicly funded supercomputer contracts resulted in an August 1987 agreement on new procedures for public-sector purchases (see JEI Report No. 29B, July 31, 1987). Since then supercomputer contracts have been awarded by three organizations covered by the accord; all of them went to domestic manufacturers. Two other contracts still are out for bid, but Cray's Japanese rivals are thought to have the inside track on both.

To many American industry and trade analysts this record indicates that Japan still has not opened up its government supercomputer procurement market. Secretary of Commerce Robert Mosbacher echoed this assessment in mid-April. Lawmakers expressed their concerns about Japanese adherence to the supercomputer procurement pact by including a "sense of the Congress" section on bilateral supercomputer trade in the 1988 trade act. The decision to target Japanese government supercomputer purchasing practices for Super 301 treatment could come down to whether the White House is willing to make this move without Cray's public support.

Soda Ash - The same question could keep another seemingly ideal candidate -- soda ash -- off the final list. American suppliers of soda ash, used primarily in glass production, have a substantial cost advantage over their Japanese rivals. Makers here can extract the product from abundant natural soda ash ore, while producers in Japan must synthesize soda ash by chemical means, an energy-intensive process. Despite this competitive edge, which has been backed up by extensive sales efforts and major expenditures on delivery and distribution facilities, U.S. manufacturers have never been able to supply more than 20 percent of the Japanese market.

American chemical companies thought they had found the solution to their problem in April 1983 when the Japan Fair Trade Commission ordered the country's four soda ash makers to disband a cartel formed in June 1973 to limit the volume of soda ash brought in from the United States and to set the prices at which the imported product would be sold to end-users. U.S. exports, which totaled about 212,000 tons in 1983, did expand afterward but not much faster than domestic demand. Renewed American complaints prompted Japan's antitrust agency to take a second look at domestic industry practices. In a November 1987 report JFTC concluded that the four Japanese soda ash producers had not formed a new import cartel. Yet even though the dollar's decline had heightened their cost advantage, U.S. companies shipped only 272,000 tons of soda ash worth $38 million to Japan last year -- a volume equivalent to 20 percent of the market.

Soda ash makers were instrumental in getting Congress to make foreign government toleration of "systematic anticompetitive activities" by local companies an actionable trade practice under Section 301 in the 1988 rewrite of that statute, but their export association, American Natural Soda Ash Corp.,

has hesitated to ask the government to apply that provision to Japan. For reasons that are equally unclear, Japan was not among the seven countries that ANSAC, in a March submission to USTR, argued should be targeted for Super 301 investigations.

Wood Products - At first glance it is hard to see why wood products would make the short list of candidates for Super 301 priority designation. After all, Japan, the world's second-largest forest products market, is the major export customer for the U.S. forest products industry. In 1988, for example, sales of wood products to Japan came to $2.2 billion, more than double the 1985 figure, as both bigger volume and higher prices swelled the export total, while shipments of paper pulp, waste paper, and paper and paper products added another $1.1 billion to the industry's revenues. The National Forest Products Association claims, however, that exports of wood products would have been at least $1.2 billion greater last year if U.S. suppliers had been able to ship more value-added products like plywood to Japan instead of logs and wood chips, which together accounted for 79 percent of sales.

In a submission to USTR the forest products trade group presented a long list of factors that it said skewed Japan's purchases of wood products from the United States toward raw materials even though Japanese mills are not cost competitive. Starting with high tariffs and tariff escalation the list went on to unnecessarily restrictive building and fire codes plus wood products standards that often are based on design criteria rather than structural performance and ended with Tokyo's land and housing policies.

Japan's numerous tariff and nontariff barriers to U.S. exports of processed wood products were one of the subjects of the 1985 MOSS negotiations. They also were the least successful. The United States eventually won tariff concessions on finished lumber, plywood, veneer, particleboard/waferboard and some other wood products as well as on paper products, but the cuts were not as deep as Washington had wanted, particularly on plywood. Moreover, progress on technical barriers to trade was skimpy. Only two regulatory changes were negotiated during the talks -- designating foreign testing organizations to certify that American exports meet Japanese lumber and plywood standards and permitting expanded use of 4x8-foot panels in construction, although two other issues were resolved after the wrap-up of the MOSS discussions.

Given the number of regulatory problems left hanging at the end of the MOSS negotiations, U.S. trade officials expected additional meetings with their Japanese counterparts. Some technical talks have been held since 1985 but no high-level meetings despite several American requests. NFPA figures the only way to get the Ministry of Agriculture, Forestry and Fisheries back to the bargaining table is to make Japan's wood products barriers a trade-liberalization priority under the Super 301 provision. Pacific Northwest legislators, including Sen. Bob Packwood (R, Ore.) and Rep. Ron Wyden (D, Ore.), share the view that Tokyo will offer additional concessions on wood products only if it has a clear incentive to do so, like the threat of retaliation. The Bush administration could be swayed by these arguments.

Automotive Parts - The United States purchased nearly $9.2 billion worth of automotive parts, engines, bodies and chassis from Japan in 1988 while sending only $417 million the other way. To many American manufacturers of original equipment and replacement automotive parts, those numbers are graphic proof

that domestic suppliers are finding it as hard as ever to crack the Japanese market despite a 10-year effort by government and industry to improve access, including a yearlong (August 1986-August 1987) discussion of automotive parts within the MOSS framework, and the enhanced price and quality competitiveness of U.S. producers. There also is agreement in the U.S. parts industry that the close ties between Japanese motor vehicle manufacturers and their traditional suppliers, not formal trade barriers, are the main reason American companies have trouble selling production parts to Japanese car and truck plants, whether in Japan or overseas, and gaining access to the worldwide aftermarket for Japanese vehicles.

Japan's automotive makers and parts suppliers have no quarrel with this description of the problem, but they do take issue with the argument that American parts makers are not making headway in winning business from Japanese car and truck builders. According to the Japan Automobile Manufacturers Association, overall purchases of American-made parts, accessories and materials by the 11 Japanese automotive makers climbed from $1.7 billion in FY 1985 to $3.1 billion in FY 1987. Moreover, purchases in the April-September 1988 period totaled $2.1 billion, 52 percent above the year-earlier level. The problem with using these numbers as the yardstick for measuring progress, U.S. suppliers are quick to point out, is that they combine parts exported to Japan with products purchased by the American production units of Japan's automotive manufacturers from transplanted Japanese parts operations as well as from U.S.-headquartered companies. And most of the growth has been in domestic sourcing by Japanese-affiliated automotive assembly plants.

With automotive products (cars, trucks and parts) accounting for 60 percent of the huge U.S. trade deficit with Japan in 1988, there is pressure on Capitol Hill and in some business circles for Super 301 action on automotive parts. The United Auto Workers union wants USTR to go after Tokyo's "toleration of anticompetitive activities by automotive vehicle producers" in their purchases of parts, components and materials. The Automotive Parts & Accessories Association also has asked the government to use the 1988 trade act to open Japan's parts market. The other major parts trade group, Motor and Equipment Manufacturers Association, has not taken a public stand, however. That alone might keep automotive parts off the final list. In addition, a number of government officials appear to be just as leery now of trying to negotiate private-sector barriers to foreign parts on a government-to-government basis as they were in 1986 when parts were added to the MOSS agenda.

Semiconductors - The odds-on favorite product for Super 301 priority designation is semiconductors. The U.S. semiconductor industry certainly feels it has a compelling case. In brief, Washington and Tokyo initialed a five-year agreement at the end of July 1986 designed to expand sales opportunities in Japan for American and other foreign semiconductor producers and to bring an end to what U.S. industry and government officials claimed were the predatory pricing policies of Japanese semiconductor makers in this country and in third markets. As part of the settlement pact the White House suspended two outstanding dumping complaints against Japanese suppliers as well as a Section 301 proceeding initiated by the Semiconductor Industry Association.

The agreement was in trouble almost from the start. Within months SIA representatives were charging that Japan was not living up to its side of the bargain. By early 1987 Reagan administration officials were threatening trade

sanctions if Japan did not comply immediately with both the pricing and the market access parts of the arrangement. Implementation did improve but not fast enough to prevent President Reagan from taking the unprecedented step of slapping 100 percent penalty tariffs on $300 million worth of Japanese-made products in mid-April 1987. The president acknowledged Japanese progress in reducing third-country dumping two months later when he rescinded $51 million in sanctions. The other $84 million in dumping-related penalty duties were lifted in early November 1987 after U.S. government monitoring confirmed that Japanese-made commodity products like DRAMs (dynamic random access memories) were being sold both here and in third markets at fair prices.

The $165 million in damages attributable to Japan's failure to improve foreign access to its semiconductor market still are in effect. The Bush administration shows no more signs of yielding on these sanctions than its predecessor did. A rollback obviously is opposed by the U.S. semiconductor industry. At times, in fact, merchant manufacturers have considered pressing the government to up the sanctions, both as a prod to Japan to get purchases of American chips on a track that will enable U.S. makers to control 20 percent of the Japanese market by the end of the semiconductor trade agreement in August 1991 and as compensation to domestic suppliers for the shortfall to date.

According to SIA data, the U.S. market share averaged 10.7 percent for all of 1988 and 10.5 percent in the year's final quarter -- not much better than the historic level of almost 10 percent, which was where the 1987 figure came in. The trade group figures that American vendors should have supplied 12.5 percent of Japanese demand in last year's first quarter and 14.2 percent in the October-December period. The gap, SIA calculates, cost U.S. semiconductor manufacturers $490 million in 1988 on top of the revenues they lost in the second half of 1986 and in 1987 because of inadequate Japanese compliance with the semiconductor pact.

Tokyo repeatedly has tried to persuade Washington that Japanese semiconductor users have made good-faith efforts to buy more from American suppliers. The trade figures underscore this fact, government officials point out. U.S. semiconductor exports to Japan expanded from $235 million in 1985, admittedly a down year in the cyclical chip business, to $458 million last year, when an additional $253 million worth of dice and wafers also were shipped out. Japanese import data show a similar increase, with yen-denominated purchases from this country jumping 37.6 percent in 1988 alone. As further proof that market access has improved, Tokyo notes that Japan's six biggest semiconductor makers (NEC Corp., Toshiba Corp., Hitachi, Ltd., Fujitsu, Ltd., Mitsubishi Electric Corp. and Oki Electric Industry Co., Ltd.), which also are among the country's top chip users, now get 18.6 percent of their semiconductor supplies on average from foreign companies -- up four percentage points from two years ago. Considering the mismatch between the types of devices that overseas, mainly American, companies produce and what Japanese industry uses in volume, Tokyo feels these numbers demonstrate that steady progress is being made whatever the market share figures might indicate.

Key Bush administration officials remain unpersuaded. Both USTR Hills and Commerce Secretary Mosbacher have expressed strong dissatisfaction on several occasions about Japan's trade record on semiconductor market access. Influential legislators certainly think Japan has come up short. Equally important, the American Electronics Association, which represents major U.S. users

of semiconductors and which frequently has been at odds with domestic semiconductor manufacturers over the trade pact, at least implicitly backs the SIA position that Japan's failure to implement the market access provisions of the semiconductor agreement should be identified as a Super 301 priority practice. That move now appears to be a foregone conclusion.

Distribution System - Japan's complex distribution system is a tempting Super 301 target for many American manufacturers of consumer durables and nondurables frustrated by the problems of marketing in Japan. The U.S. Chamber of Commerce, the only broad-based trade association to comment formally on the selection of U.S. trade-liberalization priorities, flagged Japan's distribution network as a good example of the type of generic or systemic trade practice Congress had in mind when it included the Super 301 provision in the 1988 trade law. For years administration economic policymakers also have argued that the distribution system is inherently anticompetitive. Nevertheless, the distribution system by no means is a shoo-in for priority designation. For one thing, new distribution channels for imports are opening up. More important, the Japanese government, responding just as much to domestic pressures as to foreign complaints, is on the verge of announcing changes in the administration of a law that has limited the expansion of large retailers -- the main target of official Washington's criticism (see JEI Report No. 11A, March 17, 1989).

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.